BREXIT update and Doing Business in the UK

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With you today...

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Alistair has extensive experience of successfully providing a broad range of tax services to UK inbound and multinational groups.

He predominantly works with US inbound businesses and so is active, knowledgeable and proactive in managing the relevant tax issues for such groups.

Alistair joined Smith & Williamson in 2017 from EY, having worked with large private equity backed and listed businesses for 10 years. Prior to EY, Alistair worked for PWC.

Alistair heads up Smith & Williamson's Large Corporate and International tax team and has recently been appointed to the Global Tax Committee for Nexia International.

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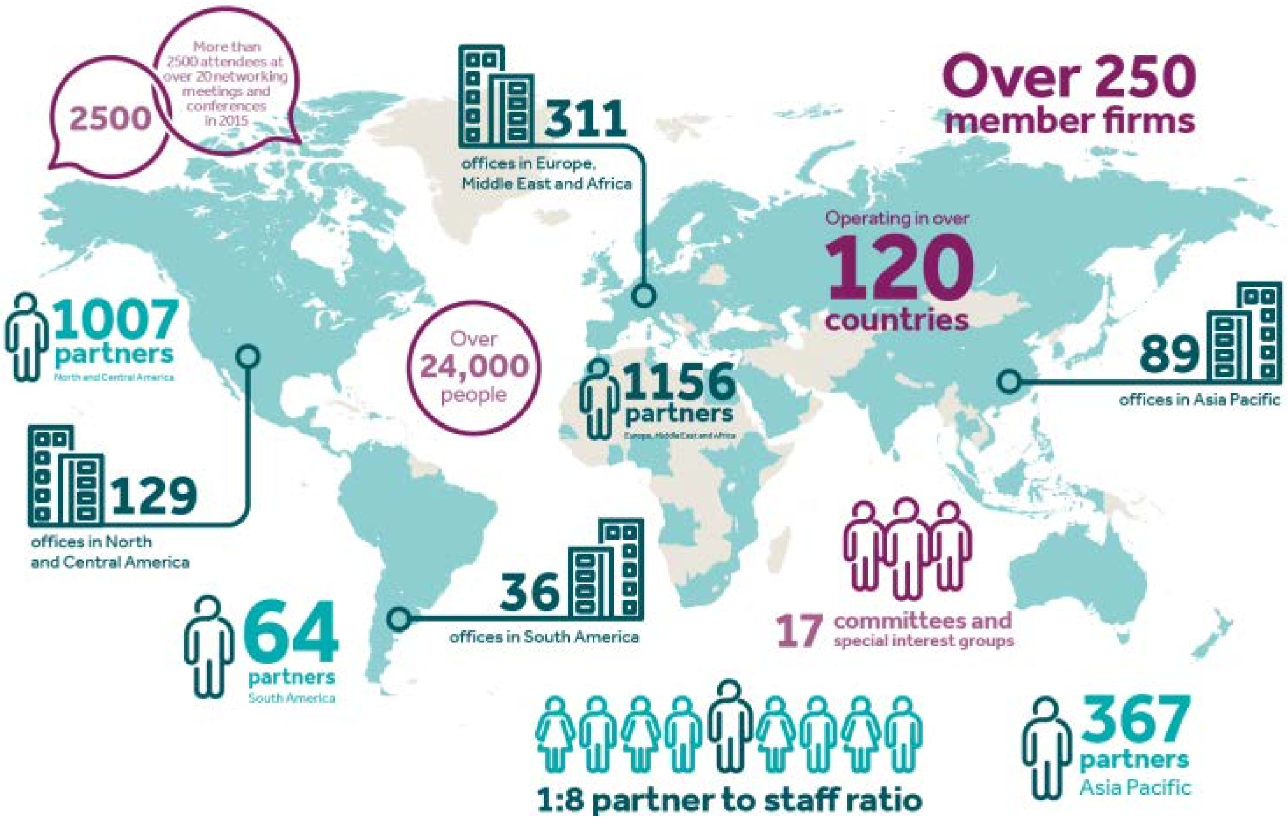
Smith & Williamson – About us

Our UK & Irish firm

- Experience - over 12,000 client accounts
- Extensive UK presence - with 12 offices in the UK
- Depth of expertise - we have over 1,700 staff and over 300 partners
- £266m turnover with over £19.5bn in funds under management
- The right fit - as the 8th largest accountancy firm in the UK we deliver high-quality, personalised services
- Global coverage - Access to over 200 firms in over 100 countries

Our Global Network – Nexia International



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Establishing a UK Presence

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Entity formation
- company or branch?

Company set up

Open UK bank account

Tax registrations

Appoint UK lawyers

Ongoing book-keeping/ Accounting

Monthly Payroll

Quarterly VAT returns

Transfer Pricing requirements

Annual filing requirements:
- cosec - statutory accounts
- Audit? – Tax return

US Inbound Investment to the UK

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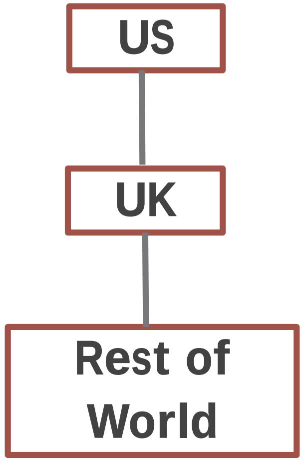
Common US/UK structure prior to US tax reform



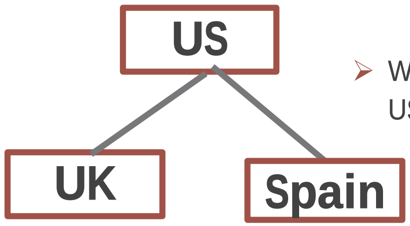
Summary of benefits:

- UK has strong double tax treaty network
- UK has dividend exemption and substantial shareholding exemption for stock disposals
- No withholding tax on dividend distributions
- No requirement to pay dividends to US

Is a UK holding company still attractive for future investment into the UK?

A recent example – Spanish acquisition:

Option 1:



- WHT on dividends to US from Spain

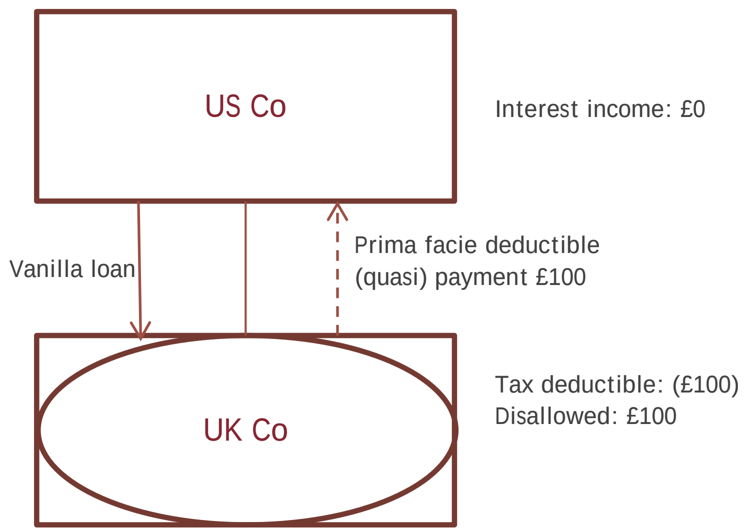
Option 2:

- Client had a commercial desire to lead European expansion from, and already had substantial in the UK
- No WHT on dividends from Spain to UK
- No WHT on dividends from UK

UK Hybrid Mismatch Rules - from 1 Jan 2017

- Intended to counteract UK deductions from cross-border transactions resulting in a difference in tax treatment which gives rise to a tax mismatch or advantage, i.e., non or under taxation in one or more jurisdictions.
- Applies to all UK payments or quasi-payments (e.g. interest, royalties, cost of goods); disallows UK deductions.
- Look for hybrid entities (e.g. partnerships), quasi-equity debt instruments, UK co, foreign PE / foreign co, UK PE.
- Rules are complex and mechanical - no motive test - common area of issue is where **US headed with disregarded UK subs.**
- UK directors will need to do work to ensure they are signing off on compliant return – auditors may ask to see.

Simplified example – loan from US to disregarded/checked UK subsidiary



DD mismatches can occur where the transactions of an investor and a hybrid entity are treated differently for tax purposes.

An amount may be deducted by both the investor and the hybrid entity.

This may result in a mismatch and UK deduction may be disallowed.

May occur in disregarded entities.

Are you maximising available UK tax incentives and reliefs?

R&D Incentive Landscape

The two key funding mechanisms in the UK to encourage and support R&D and innovation include:

R&D Tax Incentives

Patent Box

R&D Tax Incentives

The UK Government introduced the R&D tax regime in 2000.

R&D tax support from HMRC, over the past 10 years, has increased from £751m to £3.6bn, making it Government's greatest source of innovation funding.

Government monitors R&D spend as a % of GDP – aims for *2.4%* but currently at *1.7%.*

There are two types of R&D regimes in the UK:

- SME Regime
- Large Co Regime (RDEC)

Technical eligibility criteria is similar to the other 49 countries that have R&D tax incentive regimes.

Funding Mechanisms

SME

R&D Tax Credit
(loss making)

Initial R&D QE: 100%

R&D QE Uplift: 130%

Cash Credit @14.5%

Net Benefit:
(100% + 130%) * 14.5%
= <u>33.35 %</u>

R&D Tax Relief
(profit making)

R&D QE Uplift: 130%

Corporate Tax Rate: 19%

Reduction in CT Liability:
130% * 19%
= <u>24.70 %</u>

Large

RDEC

RDEC Income: 12%

Corporate Tax Rate: 19%

Net Benefit:
RDEC – RDEC CT Liability
12% - (12% * 19%)
= <u>9.72%</u>

SMEs - R&D Tax Relief (profit making companies)

SME R&D relief allows companies to:

- deduct an extra 130% of their qualifying costs from their yearly profit

<u>Example – Profit Making Company:</u>

Trade Profits = £1,000,000
Corporation Tax ("CT") Liability (@19%) = £190,000

R&D Qualifying Expenditure ("QE") = £100,000
Enhanced Deduction (@130%) = £100,000 * 130%
= £130,000

Enhanced R&D Deduction is subtracted from company trading profits
Trade Profits (post R&D) = £870,000
CT Liability (post R&D) = £870,000 * 19%
= £165,300
Therefore, savings in CT Liability = (Tax Liability Pre R&D) - (Tax Liability Post R&D)
= (£190,000) - (£165,300)
= £24,700
Therefore, the net benefit for the company is £24,700.
This equates to 24.7% of the QE

SMEs - R&D Tax Credit - (Loss Making)

Trade Profits = -£1,000,000 (i.e. losses)

Corporate Tax Liability (@19%) = £0

R&D Qualifying Expenditure ("QE") = £100,000

Enhanced Deduction (130%) = £100,000 * 130%

= £130,000

Enhanced R&D Deduction in subtracted from company trading profits

Trade Profits (post R&D) = -£1,130,000

However, companies often don't benefit from extra losses, so they are able to "cash them out" for a credit

Cash credit is 14.5% of the surrenderable loss, i.e. the lesser of:

Unrelieved trading loss in the period (£1,130,000)

or

230% QE (230% * £100,000 = £230,000)

Surrenderable loss is the lesser of these two

Therefore, **R&D Tax Credit** = **Cash Credit Rate * 230% * QE**

= 14.5% * £230,000

= £33,350

Therefore, the net benefit for the company is £33,350.

This equates to 33.35% of the QE (and is therefore more generous than relief for profit making companies)

Large Co - RDEC

The rules for identifying qualifying activities remain unchanged. It is only the way relief is given that is different.

Relief is now given as a taxable credit calculated as a percentage (12%) of the qualifying expenditure for the relevant accounting period.

This credit is treated as “other income”

- Benefit for reporting purposes
- Is therefore taxed at the relevant CT rate

R&D QE = £1,000,000
RDEC = 12% * £1,000,000
= £120,000

RDEC is treated as income, therefore tax must be paid on it
(no matter the company profit/loss position)

CT paid on RDEC = RDEC * CT Rate
= £120,000 * 19%
= £22,800

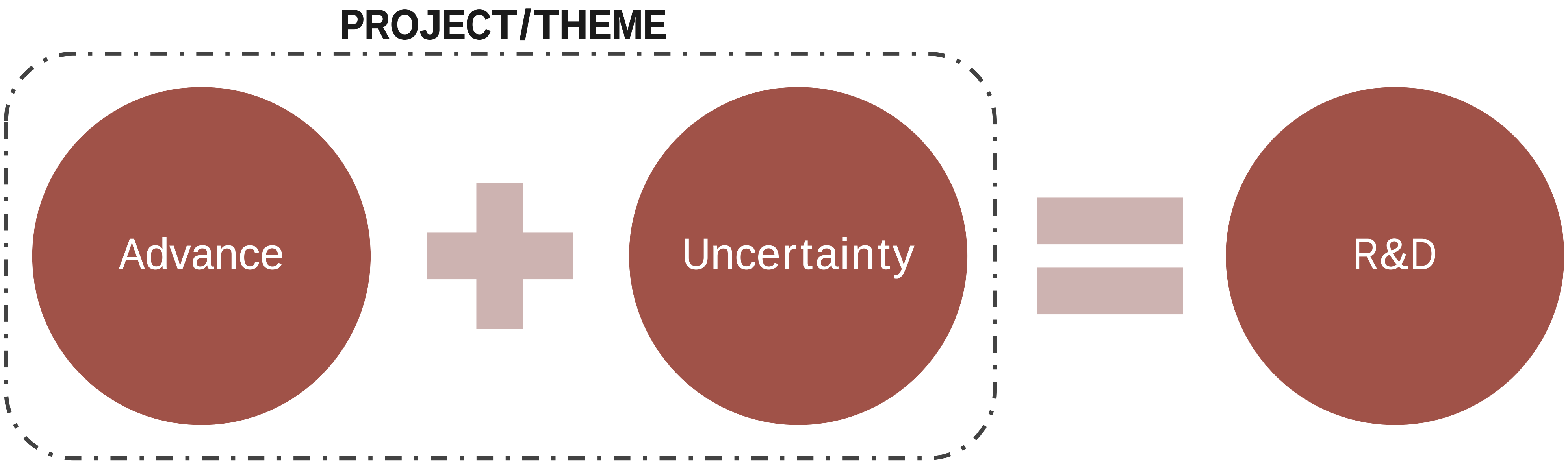
Net Benefit of RDEC = (RDEC Credit) - (RDEC CT Liability)
= (£120,000) - (£22,800)
= £97,200

RDEC Net Benefit = 9.72% of initial QE

R&D Tax - Eligibility

Broad HMRC definition of R&D:

R&D takes place when a project **seeks to advance a field of science or technology** through the **resolution of scientific or technological uncertainty.**



A broad definition is provided by HMRC so that multiple industries can be included, such as:

- Construction
- Technology & Software
- Pharmaceutical & Biotechnology
- Energy i.e. oil, gas, wind, solar, etc.

R&D Tax - Eligible Activities

The HMRC definition can be simplified into eligible R&D activities in the form of advances sought and uncertainties faced in seeking these.

Technological/scientific advances sought:

Seeking to extend the knowledge or capability within the industry

Seeking to develop a new or improved product, process, material, device or service.

Uncertainties faced:

Uncertainty in the **manner/process/path** of achieving the end result.

Uncertainty in achieving the desired **outcome/performance** of the product/process.

System Uncertainty - complexity of a system's integrated parts, rather than uncertainty over how individual components behave in isolation.

Patent Box

The UK Patent Box Regime has been in place since 2013 with the aim of increasing the investment in patent development.

- Enables companies to apply a lower rate of Corporation tax to profits earned from patents.
- Relief was phased in from April 2013 – businesses now receive an effective CT rate of 10% on Patent Box profits.
- HMRC have reported that £942m has been claimed through Patent Box relief in 2016/17.
- Only 1,025 claims made - just 3% of companies with eligible patents and claiming R&D tax credits are taking advantage of this benefit.

Patent Box - Who can benefit

Companies only

- Companies that invest in relevant R&D and are liable to UK Corporation Tax

Profits from exploitation of patents

- Must have undertaken qualifying development
- Must own exclusive licence in the patent

Eligible patents

- UK Intellectual property Office
- European Patent Office
- Certain EEA Patent Offices

Qualifying development

- Significant contribution to:
- creation or development of patented invention; or
- a product incorporating the patented invention

UK tax landscape:
Increased focus on Compliance and Governance

Corporate Criminal Offence

Failing to prevent the facilitation of tax evasion

UK tax authorities have introduced corporate criminal rules in relation to the facilitation of tax evasion

Scope

- Companies
- Partnerships
- LLPs
- Charities

Timing

Introduced by Criminal Finances Act on **30 September 2017**

Offence

Applies to all businesses that fail to prevent the facilitation of tax evasions by employees or 'associated persons'

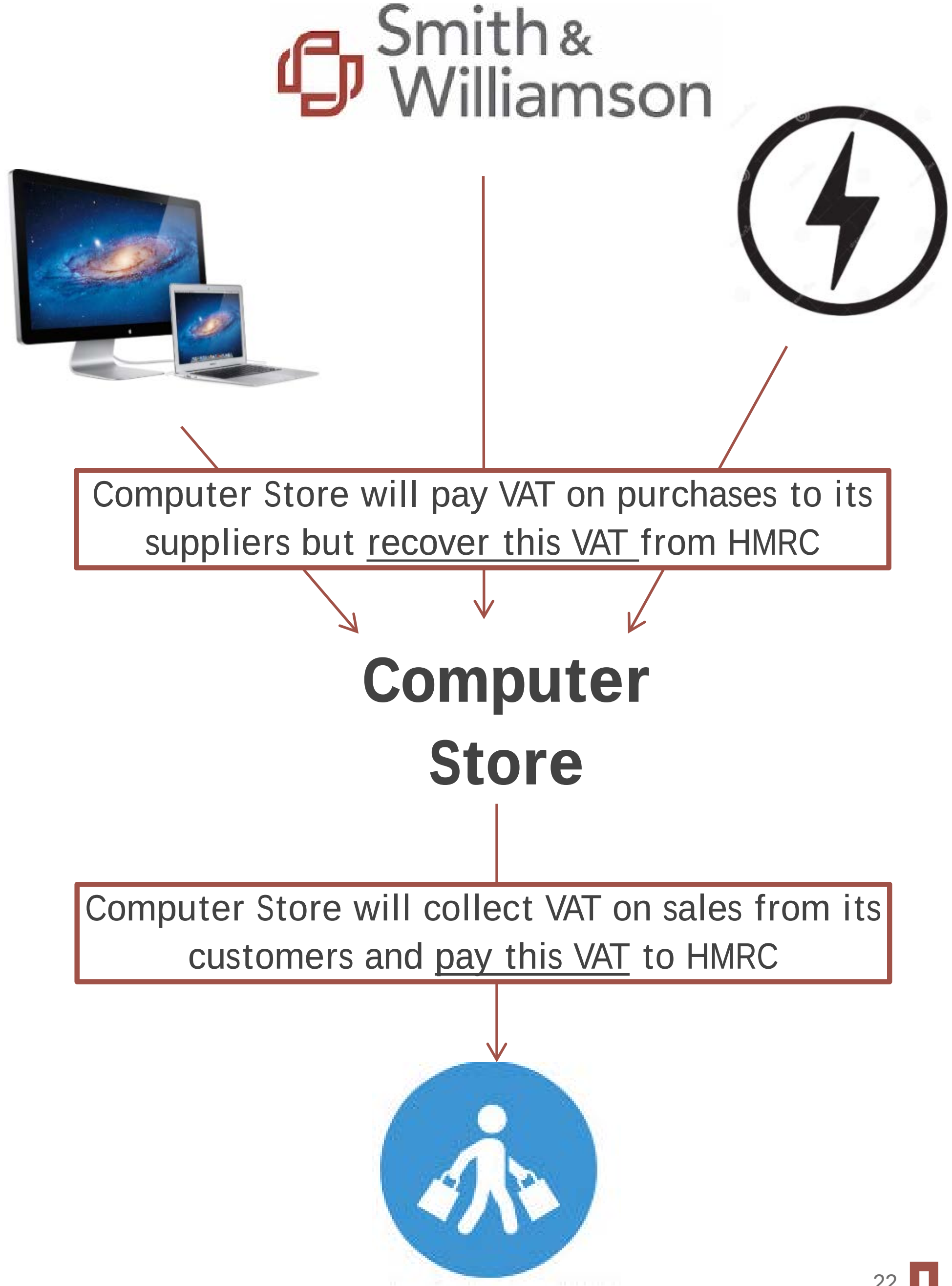
Application

UK and overseas tax evasion

- UK nexus required for facilitation of foreign tax evasion
- No UK presence required for facilitation of UK tax evasion

Recap - How does VAT work?

- VAT is an EU tax levied on the sale of goods and services sold by businesses.
- UK VAT rates (different per EU state):
  - 20%
  - 5%
  - 0% (VAT recovery on costs)
  - VAT exempt (no VAT recovery on costs)
- Where applicable, VAT is collected by businesses and paid to HMRC.
- Taxable businesses can wholly or partly recover VAT charged to them on business purchases
- VAT returns are usually filed quarterly. Annual and monthly returns can be submitted under certain circumstances.



Current "hot topic" for VAT -
What is Making Tax Digital (MTD)?

Step towards 'real time' reporting

Aim is to remove manual intervention and reduce human error

3 key elements:

When will MTD impact you?

- VAT return periods starting **on, or after, 1 April 2019** for VAT registered businesses with a taxable turnover above the VAT threshold (£85k p.a.)

- Delayed implementation until **1 October 2019** for:
  - VAT groups/divisions
  - Businesses making payments on account
  - Businesses established overseas

- Voluntary for ‘smaller’ VAT registered businesses

- Limited exemptions

Other new/topical UK tax compliance areas

1 – Senior Accounting Officer (SAO) requirements

- Applies to Group where total UK aggregated turnover exceeds £200m p.a. or Assets of £2bn
- UK Group needs to nominate SAO who will certify there are appropriate accounting procedures in place
- Personal and corporate penalties and reputational implications for non-compliance

2 – Country by Country Reporting (CBCR) requirements

- €750m global turnover threshold
- UK annual notification requirement to HMRC if reporting requirement met by Holding company in US

3 – Tax Strategy publication

- Applies if either : (i) UK group exceed SAO thresholds; or (ii) globally CBCR thresholds exceeded
- UK Group required to annually publish on UK website its tax strategy, in line with HMRC guidelines.

4 – Short term business visitor to the UK requirements

- Increased HMRC focus on business visitors to the UK from overseas group entities.
- Employee workdays in the UK could create a UK income tax withholding and NICs obligation for the employer.
- Penalties, interest and back-taxes where a company does not fulfil reporting requirements.

5 – New IR35 requirements from 2020 – payroll implications for contractors

- Under new rules (effected from April 2020), payroll requirements can fall on companies, even where the company engages with the contractor through a personal service company

BREXIT...

BREXIT - Where are we now?

23 June 2016 - UK votes to Leave – Leave Campaign wins by 51.9% to 48.1%

13 July 2016 – Theresa May becomes PM

29 March 2017 – Article 50 triggered, kick-starting a 2 year countdown to Brexit

8 June 2017 – Snap general election – May loses majority and has to do a deal with DUP to stay in power

25 November 2018 – Withdrawal agreement published – Backstop angers both the DUP and Tory Brexiteers

15 January, 12 March and 30 March 2019 – Meaningful votes on May's Withdrawal agreement deal are defeated on 3 occasions

29 March 2019 – date of original exit date. Exit date extended to 12 April

April 2019 – Indicative votes – MP's votes on a series of options to see what alternative Brexit options demand a majority – no options provide a majority

11 April 2019 – May and EU leaders agree to a 'Flextention' to 31 October 2019

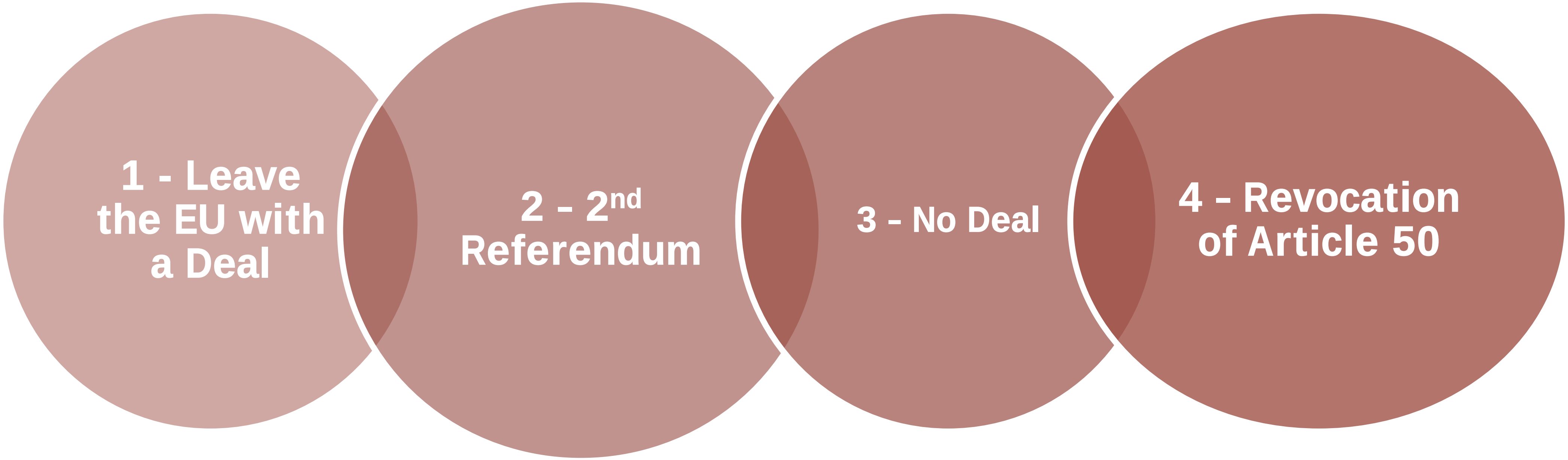
22 May 2019 – Date UK needs to have an agreed deal to avoid holding European Council elections

31 October 2019 – Brexit date, deal or no deal…

31 December 2020 – Transitional period ends, assuming UK leave the EU on 1 June

31 December 2022 – possible extension date to transitional period

Deal, No Deal, Another Referendum, No Brexit - What next?



Selling goods

Almost all the debate over the last 2½ years has been about the UK's trade with the EU in goods post Brexit, and what that will look like

- Union Customs Code
- Desire to minimise border controls and customs checks
- A "frictionless" border is key to the movement of goods for "just in time" deliveries

Implications:

- 1 in 7 EU companies using UK suppliers have moved part or all of their business out of the UK to reduce supply chain exposure
- Thousands of lorries per day pass through the UK
- Significant additional red tape costs and delays if the UK exits the EU
- Major impact for EU business as well as UK

Selling services

Services make up 80% of the UK economy, and the EU accounts for 40% of the services the UK exports.

BUT

We have had very little debate about the supply of services post Brexit.

Regulated service providers

- Passporting rights are key
- Move of financial services to Frankfurt, Paris, Milan and Dublin
- UK financial institutions have significantly reduced the expected job losses in the city of London – now expected to be 5,000
- Action should already have been taken

Non regulated service providers

- In the period immediately following Brexit we will see few major changes to UK Tax rules, so should be few issues for EU suppliers

What are we seeing - Panic or business as usual?

- Pre & Post 23 June 2016 referendum – initial uncertainty and panic…
- Weak sterling strengthened FTSE, encouraged inward investment, but also had negative impact on profits
- Following initial panic…business as usual - many businesses taking no action until further clarity known
- Many businesses back in growth mode – confidence up
- Deal flow high – little impact from Brexit
- Inbound investment still positive

What are our clients doing?

Financial Services sector

- offshored/offshoring parts of business requiring passporting rights

Other sectors

- To date, generally clients waiting and seeing…
- More businesses now starting to undertake Brexit readiness/impact assessments
- Customers seeking supply chain security - stockpiling products in UK and/or Europe
- Customers demanding European substance/footprint
- Some UK businesses setting up EU subsidiaries as a protective measure
- Some deals now impacted by Brexit

Is your business ready for a 'no deal' Brexit?

Through our clients we are seeing the following 'no deal' preparations:

1. Heat mapping areas of risk to better understand how disruption will impact the business
2. *Revision of supply agreements* – minor contract changes to trading terms may significantly increase the risks for individual businesses. Companies may force difficult terms on suppliers to minimise their Brexit risk.
3. *Consultation with distribution partners* – businesses are ensuring that their procurement departments are fully engaged with their distribution partners, flagging any potential problems as early as possible.
4. *Revisiting supply chains* – are there potential pressure points, and what are the alternative networks?
5. *People* – if businesses are heavily dependent on management or labour from EU countries, what are the alternatives?
6. *Treasury management* – consider the impact of any future change in exchange rates and whether any adverse changes can be mitigated
7. *Reviewing EU footprint - should you incorporate an EU presence? Should you move any parts of your business and what would be the tax implications of this?*
8. *Understanding and quantifying risks* – companies are modelling the potential impact of tariffs/delays/ other Brexit implications

Tax impacts of ‘no-deal’ scenario

Customs duty

- Currently, goods move freely among the UK and EU countries. Post Brexit, customs duties may be imposed on import in a “no-deal” scenario. This could lead to a financial cost as well as administration burden / delays

VAT

- Confirmation that UK to continue operating VAT system after leaving the EU and no major ‘day 1’ changes for most businesses
- Intention to introduce postponed accounting for import VAT to reduce cash flow impact on businesses

Direct tax

- UK will no longer be subject to EU law including EU directives
- WHT obligations on dividends, royalties and interest would be dependant on double tax treaties – there may be little or no impact, but this should be considered
- Corporation Tax generally embedded in UK law so unlikely to be other significant changes

Overview of Brexit impact on Customs Duties

Remember: Customs duties are paid in addition to VAT and are a specific percentage applied to the value of the goods entering the country

Pre Brexit

Customs duties are paid on goods when they enter Europe.

Subsequent movement of goods between EU member states do not attract further customs duties.

Post Brexit

Customs Duties will be due on goods entering the UK from any country.

Customs Duties will also be due on goods entering Europe regardless of whether customs duty has or will be paid in the UK!

Double customs duties!!

HMRC have confirmed that as a temporary measure post Brexit, 87% of goods coming into the UK will be subject to 0% duty!

Recommendations

Consider custom duty regimes including custom duty warehouses and duty deferment schemes

Apply for an EORI number in the UK – registration number necessary in order import goods into the UK post Brexit

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